

Media Release:

# Chung Hung Steel Corp. Outlook Revised To Positive Following Similar Parent Action; 'twA/twA-1' Ratings Affirmed

April 28, 2022

## Rating Action Overview

- **Chung Hung Steel Corp.** is a specialized downstream steel processor with production capacity of 2.4 million tons (Mt) for hot-rolled coils and EBITDA of new Taiwan dollar (NT\$) 7.3 billion in 2021.
- We recently revised the rating outlook on Chung Hung's parent company, **China Steel Corp.**, to positive from stable. We view Chung Hung as a highly strategic subsidiary of China Steel, therefore, the ratings and outlook on Chung Hung move in tandem with those on the parent.
- We have revised our outlook on the long-term issuer credit rating on Chung Hung Steel to positive from stable to reflect our view that solid steel demand and an acceleration in debt reduction could help sustain China Steel's ratio of funds from operations (FFO) to debt above 30% over the next two years.
- At the same time, we affirmed our 'twA' long-term and 'twA-1' short-term issuer credit ratings on Chung Hung Steel.

## Rating Action Rationale

*Positive outlook revision follows that on the parent China Steel Corp.* The outlook revision on Chung Hung Steel follows the same action we took on the outlook on the rating on its parent company, China Steel Corp. This incorporates our view that solid demand outlook during the current supply shortage supports China Steel's strong operating cash flow generation in 2022. We believe the acceleration in debt reduction brings upside to our ratings on China Steel. A lower debt level and strong operating cash flow generation could support the company's ratio of FFO to debt at 30%-42% over the next two years.

*The ratings on Chung Hung Steel reflect our view of the company's highly strategic membership of the China Steel group.* We view Chung Hung Steel as a highly strategic member of the China Steel group. This reflects the fact that China Steel is the single largest shareholder with about 40% share of the company, allowing it control of Chung Hung Steel's board of directors. Chung Hung Steel's operations are very important to the group to maintain its dominant share in the domestic market. Therefore, we assess the long-term rating on Chung Hung Steel at one

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notch below China Steel's stand-alone credit profile, and the ratings and outlook on Chung Hung move in tandem with those on its parent.

## Outlook

The positive rating outlook on Chung Hung Steel reflects the positive rating outlook on its parent, China Steel, given our view of Chung Hung Steel as a highly strategic subsidiary of the parent group. The outlook reflects an acceleration in China Steel's deleveraging boosted by ultra-strong performance in 2021. The outlook also reflects likely continued robust operating cash flow amid solid steel demand and tight global steel supply in 2022, which could sustain China Steel's ratio of FFO to debt at 38%-42%. Nonetheless, the sustainability of this ratio above our upside trigger with sufficient buffer remains to be tested. That's because of the inherent cyclical nature in the steel industry and the necessity for China Steel to reduce its carbon emissions, which could result in higher capital spending than we currently forecast.

### Upward scenario

We may raise the long-term rating if China Steel could sustain its profitability and lower its debt, such that the ratio of FFO to debt stays above 30% on a sustainable basis. Such improvement could be achieved by:

- Continued debt reduction through strong operating cash flow generation without aggressive investments and capex; or
- China Steel's cost competitiveness and product mix further strengthen, accompanied by a sustained demand and supply balance in the regional steel market.

### Downward scenario

Conversely, we could revise the outlook on China Steel back to stable if the ratio of FFO to debt falls below 30% over the next two to three years, possibly due to:

- A contraction in demand and intense competition;
- Persistently high raw material prices that squeeze the company's profit margin; or
- China Steel adopts a much more aggressive capex plan that curbs its ability to deleverage.

## Ratings Score Snapshot

**Issuer Credit Rating:** twA/Positive/twA-1

Note: The descriptors below are on a global scale

### Business Risk: Weak

- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Weak

### Financial Risk: Significant

- Cash flow/Leverage: Significant

**Anchor:** twbbb

### Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Positive (+1 notch)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Fair (no impact)

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- **Comparable rating analysis:** Neutral (no impact)

### Stand-alone credit profile: twbbb+

- Group stand-alone credit profile (which excludes external support): twa+
- Entity status within group: Highly strategic (one notch below the group credit profile)

## Related Criteria & Research

### Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities - November 13, 2012
- General Criteria: Principles Of Credit Ratings - February 16, 2011

### Related Research

- Taiwan Ratings' Ratings Definitions – August 10, 2020
- Media Release: China Steel Corp. Outlook Revised To Positive From Stable On Accelerated Deleveraging; 'twAA-/twA-1+' Ratings Affirmed

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## Ratings List

### Ratings Affirmed; Outlook Action

	To	From
<b>Chung Hung Steel Corp.</b>		
Issuer Credit Rating	twA/Positive/twA-1	twA/ Stable /twA-1

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.taiwanratings.com](http://www.taiwanratings.com) for further information. Complete ratings information is available to subscribers of Rating Research Service at [rrs.taiwanratings.com.tw](http://rrs.taiwanratings.com.tw). All ratings affected by this rating action can be found on Taiwan Ratings' public website at [www.taiwanratings.com](http://www.taiwanratings.com).

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